OPEN MEETING

MEMORANDUM

TO: THE COMMISSION

FROM: Utilities Division

DATE: July 29, 2010

RE: TUCSON ELECTRIC POWER COMPANY – APPLICATION FOR APPROVAL OF NEW DISTRIBUTED GENERATION INCENTIVES (DOCKET NO. E-01933A-10-0278)

On July 7, 2010, Tucson Electric Power Company ("TEP" or "Company") filed an application to modify its up-front incentives for residential distributed generation ("DG"). TEP's application also requested Commission guidance on if and how the Company should address small commercial DG. On July 14, 2010, TEP filed an amended application that made minor corrections to the initial application.

TEP's 2010 Renewable Energy Standard Tariff ("REST") plan was approved by the Commission in Decision No. 71465 (January 26, 2010), including various incentive levels, REST charge levels, and a budget. Under the 2010 REST plan, the up-front incentive for grid-tied residential DG was set at $3.00 per watt and the small commercial DG incentive was set at $2.50 per watt. TEP's application requests Commission approval to lower the grid-tied residential DG incentive to $2.25, effective July 7, 2010, this application's filing date. TEP states that this reduction is required because the Company is running out of money for the grid-tied residential DG and is out of money for small commercial DG for the remainder of 2010. TEP further states that without Commission approval of a reduction in the residential DG incentive for 2010, the incentive funds are expected to be depleted by mid-August 2010.

On July 2, 2010, TEP sent out a letter to installers, indicating it was reducing incentives to $2.25, effective July 2, 2010, thus conflicting with the July 7, 2010 implementation date contained in TEP's filing with the Commission. TEP has indicated to Staff that it prefers the July 7, 2010, implementation date for the incentive reduction. Staff believes July 7, 2010 is a reasonable date for reduction of the incentives. TEP indicated it had approximately $5.4 million in residential DG funds available as of June 20, 2010. TEP has also indicated to Staff that approximately $2.8 million worth of reservations took place from June 21, 2010 to July 6, 2010. Thus, as of July 7, 2010, approximately $2.6 million remained for residential DG incentives.

The second part of TEP's application is fashioned as a request for Commission guidance on possible actions regarding the small commercial DG program for 2010. As noted above, there currently is no money for the remainder of 2010 for small commercial DG. TEP presents three possible options to address the small commercial DG program for the remainder of 2010. The three options are: (i) to do nothing; (ii) to somehow revise the overall REST program budget, caps, rates, etc. for the remainder of 2010; or (iii) to shift money from the commercial performance-based scenario to provide further funding for small commercial up-front incentives. TEP does not request approval of any of the options, but states that the Company has no preference. TEP's application indicates that there is $3 million available in the commercial performance-based incentives ("PBI") budget if a decision were made to shift money from there to up-front incentives.

Regarding this portion of TEP's filing, Staff believes that it is problematic when a utility makes a filing with the Commission, seeking guidance, but does not request any specific action in its application. In such a situation, Staff is burdened with making an initial proposal as to what course of action should be taken by the Commission on a matter specific to the Company, rather than the Company doing so, as has traditionally been the case. To date, the Company has not taken a position in this docket, indicating which of the three options it wishes the Commission to act on. The procedural difficulties in dealing with TEP's approach to this issue required additional Staff time and delayed processing of the overall application. Staff has discussed this matter with TEP, and it is Staff's understanding that TEP will work to ensure that applications it puts before the Commission in the future actually seek specific action of some sort by the Commission.

Regarding the residential DG program, the 2010 REST plan included $17,688,706 for residential incentives. As shown in the table below, $12,268,330 of residential DG incentives have been committed as of the end of June 2010, with $5,420,376 remaining for the rest of 2010.

	January 2010	February 2010	March 2010	April 2010	May 2010	June 2010
Monthly Commitment	$926,405	$2,149,776	$1,033,556	$1,986,931	$3,050,163	$3,121,499
Total Commitment	$926,405	$3,076,181	$4,109,737	$6,096,668	$9,146,831	$12,268,330

TEP has since indicated to Staff that as of July 23, 2010, approximately $1.7 million in residential DG funds remain, meaning that roughly $3.7 million has been committed during the first three weeks in July 2010. This raises the very real possibility that the entire $5.4 million left at the end of June 2010 will be committed by the time this matter comes before the Commission for action. However, if incentives are reduced, this funding would be stretched further, allowing more systems to be installed for the same amount of funding.

Given developments in recent months, Staff believes that TEP's concern regarding depletion of the residential DG incentive funds well before the end of 2010 is warranted. System costs have fallen, as noted in TEP's application, and Arizona Public Service Company ("APS") recently had its residential grid-tied DG incentive reduced to $2.15 for 3 MW and then $1.95 for further MW (Decision No. 71686, April 30, 2010), after facing budget challenges similar to those faced by TEP in this proceeding.

Given available information, Staff believes that the Commission should reduce the residential grid-tied DG incentive even lower than proposed by TEP in its application. Staff further believes that a tiered incentive approach should be employed to allow for a step-down in the incentive level as further funds are consumed within TEP's service territory.

The current small commercial DG incentive is $2.00 per watt. Staff believes that, as with the residential DG incentive, the small commercial DG incentive should be reduced in light of recent market conditions, with a similar two-tiered incentive structure, as Staff is proposing for residential DG.

Regarding TEP's small commercial DG program, TEP's filing indicates that there is approximately $3 million in available funds that are currently designated for TEP's commercial PBI program. Subsequently, TEP has indicated to Staff that it projects that $3.7 million in commercial PBI funds will go unspent through the end of 2010. TEP has also indicated to Staff that TEP has $4.5 million of unspent 2009 REST funds from the residential sector. Staff believes that both the $3.7 million in 2010 commercial PBI funds and the 2009 unspent residential funds should be used to supplement available funds for residential and commercial DG for the remainder of 2010. Staff believes that a reasonable allocation of these funds would be to move the $3.7 million of commercial PBI funds to fund small commercial DG and the $4.5 million in 2009 unspent residential funds to fund residential DG for the remainder of 2010. This would provide significant additional resources to both the residential and commercial DG sectors for the remainder of 2010, while also retaining sufficient commercial PBI funds. This would also retain all residential and commercial dollars within their respective sectors.

Staff is therefore proposing a two-tiered incentive structure for the remainder of 2010, with roughly half of the available funds in the first tier and roughly half of the available funds in the second tier. For residential DG, a total of roughly $7.1 million would be available after July 7, 2010 ($4.5 million of unspent 2009 residential funds, and $2.6 million of remaining 2010 residential DG funds as of July 7, 2010) to fund residential DG for the remainder of 2010 under the Staff proposal. Staff recommends that the TEP residential grid-tied DG incentive should be reduced to $2.00 per watt for the first $3,500,000 on July 7, 2010, and be reduced further to $1.75 per watt for the remaining funds after the initial $3,500,000 block, for the rest of 2010. Staff believes that TEP's proposed July 7, 2010, date for implementation of the lower incentive levels is reasonable and should be adopted. Staff recognizes that some customers may have signed up since July 7th, expecting the $2.25 per watt incentive level TEP has proposed, but Staff believes that the lower incentive levels are justified given market conditions.

As discussed above, Staff is recommending that TEP shift $3.7 million from 2010 commercial PBI funding to small commercial DG funding. Staff recommends that the small commercial incentive be reduced from the current $2.00 per watt level to $1.75 per watt for the first $2,000,000 in funds shifted from the PBI program, and $1.50 for the remaining small commercial DG funds for the rest of 2010.

The tables below summarize treatment of funds and incentives under the Staff proposal.

Residential DG Incentive Levels	
Current incentive	$3.00 per watt
TEP Proposed	$2.25 per watt
Staff Proposed	$2.00 per watt, for the first $3.5 million of funds as of July 7, 2010 $1.75 per watt, for remaining funds beyond the initial $3.5 million available as of July 7, 2010

Small Commercial DG Incentive Levels	
Current incentive	$2.00 per watt
TEP Proposed	No proposal
Staff Proposed	$1.75 per watt, for the first $2.0 million of funds as of July 7, 2010 $1.50 per watt, for remaining funds beyond the initial $2.0 million available as of July 7, 2010

Funding Source	**Current Status**	**Staff Proposal**
Existing 2010 Residential DG funds	$5.4 million remains as of July 1st, $2.6 million remains as of July 7, 2010, and $1.7 million remains as of July 23rd	Continue applying to residential DG, with the two-tiered approach for funds remaining as of July 7, 2010
$4.5 million of 2009 residential funds remaining	Would roll over into 2011 REST budget	Apply to residential DG for the remainder of 2010, with the two-tiered approach for funds remaining as of July 7, 2010
$3.7 million in projected unspent 2010 commercial PBI funds	Would remain in PBI funding and would likely roll over into 2012 REST budget	Apply to small commercial DG UFI's for the remainder of 2010, with the two-tiered approach for funds remaining as of July 7, 2010

In summary, Staff makes the following recommendations:

1. The shift to lower incentives beginning with projects as of July 7, 2010

2. $4.5 million in 2009 residential funds that was unspent be shifted to fund 2010 residential DG

3. $3.7 million in 2010 commercial PBI funding be shifted to fund 2010 small commercial DG

4. The residential DG incentive be reduced to $2.00 per watt as of July 7, 2010 for the first $3.5 million of funds expended on or after July 7, 2010. The residential DG incentive be further reduced to $1.75 per watt for further 2010 residential DG funds after July 7, 2010, beyond the initial $3.5 million of funds to be expended at $2.00 per watt.

5. The small commercial DG incentive be reduced to $1.75 per watt as of July 7, 2010 for the first $2.0 million of funds expended on or after July 7, 2010. The small commercial DG incentive be further reduced to $1.50 per watt for further 2010 small commercial DG funds after July 7, 2010, beyond the initial $2.0 million of funds expended at $1.75 per watt.

Steven M. Olea
Director
Utilities Division

SMO:RGG:lhm\RM

ORIGINATOR: Robert G. Gray

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
Commissioner
BOB STUMP
Commissioner

IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR APPROVAL OF NEW DISTRIBUTED GENERATION INCENTIVES	DOCKET NO. E-01933A-10-0278 DECISION NO. __________ ORDER

Open Meeting
August 12, 2010
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Tucson Electric Power Company ("TEP" or "Company") is engaged in providing electric service within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission.

2. On July 7, 2010, TEP filed an application to modify its up-front incentives for residential distributed generation ("DG"). TEP's application also requested Commission guidance on if and how the Company should address small commercial DG.

3. On July 14, 2010, TEP filed an amended application that made minor corrections to the initial application.

4. TEP's 2010 Renewable Energy Standard Tariff ("REST") plan was approved by the Commission in Decision No. 71465 (January 26, 2010), including various incentive levels, REST charge levels, and a budget. Under the 2010 REST plan, the up-front incentive for grid-tied

residential DG was set at $3.00 per watt and the small commercial DG incentive was set at $2.50 per watt.

5. TEP's application requests Commission approval to lower the grid-tied residential DG incentive to $2.25, effective July 7, 2010, this application's filing date. TEP states that this reduction is required because the Company is running out of money for the grid-tied residential DG and is out of money for small commercial DG for the remainder of 2010.

6. TEP further states that without Commission approval of a reduction in the residential DG incentive for 2010, the incentive funds are expected to be depleted by mid August 2010.

7. On July 2, 2010, TEP sent out a letter to installers, indicating it was reducing incentives to $2.25, effective July 2, 2010, thus conflicting with the July 7, 2010 implementation date contained in TEP's filing with the Commission. TEP has indicated to Staff that it prefers the July 7, 2010, implementation date for the incentive reduction.

8. Staff believes July 7, 2010 is a reasonable date for reduction of the incentives. TEP indicated it had approximately $5.4 million in residential DG funds available as of June 20, 2010. TEP has also indicated to Staff that approximately $2.8 million worth of reservations took place from June 21, 2010 to July 6, 2010. Thus, as of July 7, 2010, approximately $2.6 million remained for residential DG incentives.

9. The second part of TEP's application is fashioned as a request for Commission guidance on possible actions regarding the small commercial DG program for 2010. As noted above, there currently is no money for the remainder of 2010 for small commercial DG.

10. TEP presents three possible options to address the small commercial DG program for the remainder of 2010. The three options are: (i) to do nothing; (ii) to somehow revise the overall REST program budget, caps, rates, etc. for the remainder of 2010; or (iii) to shift money from the commercial performance-based scenario to provide further funding for small commercial up-front incentives.

11. TEP does not request approval of any of the options, but states that the Company has no preference. TEP's application indicates that there is $3 million available in the commercial

performance-based incentives ("PBI") budget if a decision were made to shift money from there to up-front incentives.

12. Regarding this portion of TEP's filing, Staff believes that it is problematic when a utility makes a filing with the Commission, seeking guidance, but does not request any specific action in its application. In such a situation, Staff is burdened with making an initial proposal as to what course of action should be taken by the Commission on a matter specific to the Company, rather than the Company doing so, as has traditionally been the case.

13. To date, the Company has not taken a position in this docket, indicating which of the three options it wishes the Commission to act on. The procedural difficulties in dealing with TEP's approach to this issue required additional Staff time and delayed processing of the overall application.

14. Staff has discussed this matter with TEP and it is Staff's understanding that TEP will work to ensure that applications it puts before the Commission in the future actually seek specific action of some sort by the Commission.

15. Regarding the residential DG program, the 2010 REST plan included $17,688,706 for residential incentives. As shown in the table below, $12,268,330 of residential DG incentives have been committed as of the end of June 2010, with $5,420,376 remaining for the rest of 2010.

	January 2010	February 2010	March 2010	April 2010	May 2010	June 2010
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Total Commitment	$926,405	$3,076,181	$4,109,737	$6,096,668	$9,146,831	$12,268,330

16. TEP has since indicated to Staff that as of July 23, 2010, approximately $1.7 million in residential DG funds remain, meaning that roughly $3.7 million has been committed during the first three weeks in July 2010. This raises the very real possibility that the entire $5.4 million left at the end of June 2010 will be committed by the time this matters comes before the Commission for action. However, if incentives are reduced, this funding would be stretched further, allowing more systems to be installed for the same amount of funding.

17. Given developments in recent months, Staff believes that TEP's concern regarding depletion of the residential DG incentive funds well before the end of 2010 is warranted.

18. System costs have fallen, as noted in TEP's application, and Arizona Public Service Company ("APS") recently had its residential grid-tied DG incentive reduced to $2.15 for 3 MW and then $1.95 for further MW (Decision No. 71686, April 30, 2010), after facing budget challenges similar to those faced by TEP in this proceeding.

19. However, given available information, Staff believes that the Commission should reduce the residential grid-tied DG incentive even lower than proposed by TEP in its application. Staff further believes that a tiered incentive approach should be employed to allow for a step-down in the incentive level as further funds are consumed within TEP's service territory.

20. The current small commercial DG incentive is $2.00 per watt. Staff believes that, as with the residential DG incentive, the small commercial DG incentive should be reduced in light of recent market conditions, with a similar two-tiered incentive structure, as Staff is proposing for residential DG.

21. Regarding TEP's small commercial DG program, TEP's filing indicates that there is approximately $3 million in available funds that are currently designated for TEP's commercial PBI program. Subsequently, TEP has indicated to Staff that it projects that $3.7 million in commercial PBI funds will go unspent through the end of 2010. TEP has also indicated to Staff that TEP has $4.5 million of unspent 2009 REST funds from the residential sector.

22. Staff believes that both the $3.7 million in 2010 commercial PBI funds and the 2009 unspent residential funds should be used to supplement available funds for residential and commercial DG for the remainder of 2010. Staff believes that a reasonable allocation of these funds would be to move the $3.7 million of commercial PBI funds to fund small commercial DG and the $4.5 million in 2009 unspent residential funds to fund residential DG for the remainder of 2010. This would provide significant additional resources to both the residential and commercial DG sectors for the remainder of 2010, while also retaining sufficient commercial PBI funds. This would also retain all residential and commercial dollars within their respective sectors.

23. Staff has proposed a two-tiered incentive structure for the remainder of 2010, with roughly half of the available funds in the first tier and roughly half of the available funds in the second tier.

24. For residential DG, a total of roughly $7.1 million would be available after July 7, 2010 ($4.5 million of unspent 2009 residential funds, and $2.6 million of remaining 2010 residential DG funds as of July 7, 2010) to fund residential DG for the remainder of 2010 under the Staff proposal.

25. Staff has recommended that the TEP residential grid-tied DG incentive should be reduced to $2.00 per watt for the first $3,500,000 on July 7, 2010, and be reduced further to $1.75 per watt for the remaining funds after the initial $3,500,000 block, for the rest of 2010. Staff believes that TEP's proposed July 7, 2010 date for implementation of the lower incentive levels is reasonable and should be adopted.

26. Staff recognizes that some customers may have signed up since July 7th, expecting the $2.25 per watt incentive level TEP has proposed, but Staff believes that the lower incentive levels are justified given market conditions.

27. As discussed above, Staff has recommended that TEP shift $3.7 million from 2010 commercial PBI funding to small commercial DG funding. Staff has recommended that the small commercial incentive be reduced from the current $2.00 per watt level to $1.75 per watt for the first $2,000,000 in funds shifted from the PBI program, and $1.50 for the remaining small commercial DG funds for the rest of 2010.

28. The tables below summarize treatment of funds and incentives under the Staff proposal.

Residential DG Incentive Levels	
Current incentive	$3.00 per watt
TEP Proposed	$2.25 per watt
Staff Proposed	$2.00 per watt, for the first $3.5 million of funds as of July 7, 2010 $1.75 per watt, for remaining funds beyond the initial $3.5 million available as of July 7, 2010

Small Commercial DG Incentive Levels	
Current incentive	$2.00 per watt
TEP Proposed	No proposal
Staff Proposed	$1.75 per watt, for the first $2.0 million of funds as of July 7, 2010 $1.50 per watt, for remaining funds beyond the initial $2.0 million available as of July 7, 2010

Funding Source	Current Status	Staff Proposal
Existing 2010 Residential DG funds	$5.4 million remains as of July 1st, $2.6 million remains as of July 7, 2010, and $1.7 million remains as of July 23rd	Continue applying to residential DG, with the two-tiered approach for funds remaining as of July 7, 2010
$4.5 million of 2009 residential funds remaining	Would roll over into 2011 REST budget	Apply to residential DG for the remainder of 2010, with the two-tiered approach for funds remaining as of July 7, 2010
$3.7 million in projected unspent 2010 commercial PBI funds	Would remain in PBI funding and would likely roll over into 2012 REST budget	Apply to small commercial DG UFI's for the remainder of 2010, with the two-tiered approach for funds remaining as of July 7, 2010

29. In summary, Staff has made the following recommendations:

- The shift to lower incentives beginning with projects as of July 7, 2010
- $4.5 million in 2009 residential funds that was unspent be shifted to fund 2010 residential DG
- $3.7 million in 2010 commercial PBI funding be shifted to fund 2010 small commercial DG
- The residential DG incentive be reduced to $2.00 per watt as of July 7, 2010 for the first $3.5 million of funds expended on or after July 7, 2010. The residential DG incentive be further reduced to $1.75 per watt for further 2010 residential DG funds after July 7, 2010, beyond the initial $3.5 million of funds to be expended at $2.00 per watt.
- The small commercial DG incentive be reduced to $1.75 per watt as of July 7, 2010 for the first $2.0 million of funds expended on or after July 7, 2010. The small commercial DG incentive be further reduced to $1.50 per watt for further 2010 small commercial DG funds after July 7, 2010, beyond the initial $2.0 million of funds expended at $1.75 per watt.

CONCLUSIONS OF LAW

1. TEP is an Arizona public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution.

2. The Commission has jurisdiction over TEP and over the subject matter of the application.

3. The Commission, having reviewed the application and Staff's Memorandum dated July 29, 2010, concludes that it is in the public interest to approved the reduced incentive levels and funding changes as proposed by Staff.

ORDER

IT IS THEREFORE ORDERED that the Tucson Electric Power Company funding and incentive levels identified in Finding of Fact No. 29 be and hereby are approved.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN	COMMISSIONER

COMMISSIONER	COMMISSIONER	COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _______day of ___________________ , 2010.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT: ____________________________

DISSENT: ____________________________

SMO:RGG:lhm\RM

SERVICE LIST FOR: TUCSON ELECTRIC POWER COMPANY
DOCKET NO. E-01933A-10-0278

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